THE MISSOURI BUDGET
FISCAL YEAR 2005
BUDGET SUMMARY

I. PROTECTING EDUCATION

Overview

Governor Holden's highest priority has always been education. He understands providing a quality education to Missouri's children is the best way to ensure the future success of this state and all its citizens. A high quality education leads to better school attendance, higher test scores, and greater success in college and the workplace. Missouri has made great strides in improving education opportunities for our children. For example:

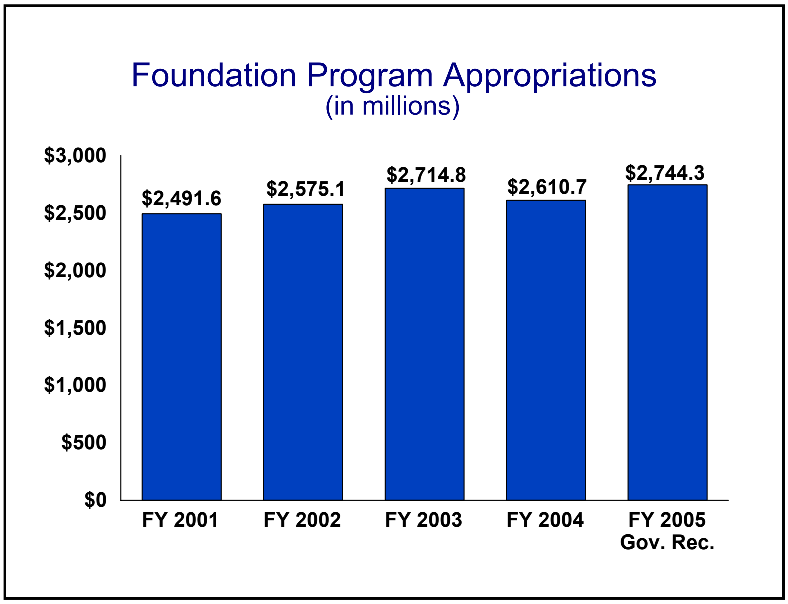
- Between 1996 and 2003 high school graduation rates increased from 74.9 percent to 84.2 percent. Missouri now ranks in the top ten nationally on high school completion rates.
- Missouri's students have shown significant progress on the National Assessment of Educational Progress (NAEP). The percentage of 4th graders scoring at or above the proficient level in mathematics has improved from 19 percent to 30 percent. Those scoring proficient or above in reading rose from 30 percent to 34 percent.
- At the eighth grade level, the percentage scoring at or above the proficient level rose from 28 percent to 34 percent in reading while the mathematics scores improved from 20 percent to 28 percent.
- All 2003 Missouri scores are above the national average except 4th grade mathematics, which is one point below the national percentage.
- 57 more teachers have become accredited through National Board Certification, bringing the total certified in the state to 199.

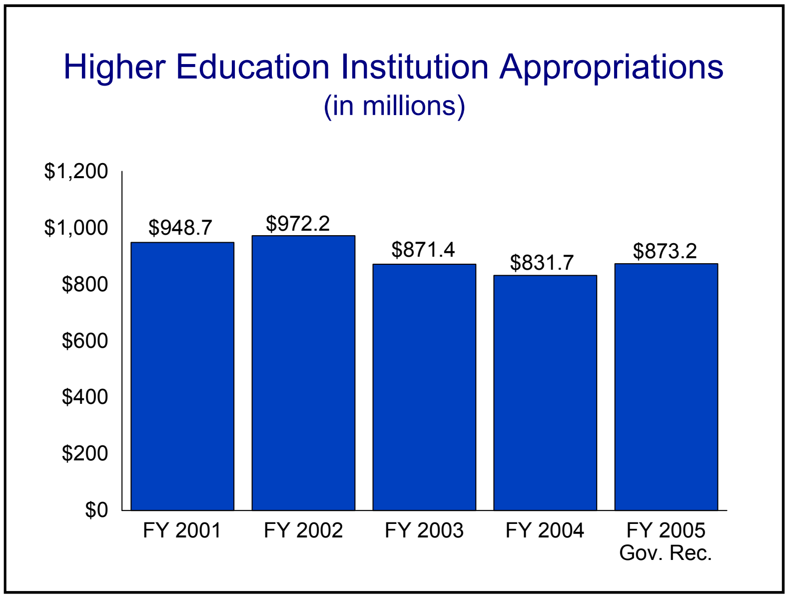
However, these successes are in jeopardy due to the continuing budget shortfall. If the state is to have a vibrant economy in the future, schools must be protected from devastating cuts that inevitably lead to fewer teachers, larger class size, fewer classroom resources, and lower academic achievement for students. A quality education in the elementary and secondary grades prepares students for success in higher education, at both our two- and four-year colleges and universities. Higher education opportunities are critical for workers who need the skills they can gain in higher education to be successful in the jobs of the future. Missouri's economic future will be dictated by our ability to compete with other states and countries throughout the world for jobs. Businesses will only choose to locate and stay in Missouri if they have access to the resources they need. The most critical resource for businesses is an adaptable, technologically savvy workforce.

The Governor's budget recommendations for Fiscal Year 2004 included a carefully balanced mix of additional reductions to state spending and targeted revenue enhancements to protect education from cuts. Unfortunately, last session the General Assembly failed to act on the Governor's calls to protect education. They refused to close egregious tax loopholes for corporations and, instead, reduced funding for education.

- In Fiscal Year 2004, the General Assembly cut $115.8 million from the school foundation program. Since a significant percentage of the foundation program supports teacher salaries, school districts were forced to eliminate 2,001 classroom teachers and aides. An additional 508 positions were also reduced including principals, supervisors, library/media personnel, guidance personnel, and administrative staff. Reductions to the school foundation program have forced school districts to increase class sizes and eliminate programs for gifted, at-risk, and disruptive students. The Governor's Fiscal Year 2005 budget restores this money.

- The General Assembly also cut $40 million from higher education institutions. As a result, tuition at public colleges and universities rose an average of 14.8 percent while tuition at community colleges rose an average of 9.3 percent. The average Missouri student now pays $1,344 more per year to attend a four-year institution and $342 more to attend a two-year institution. These increases were simply taxes in disguise and have placed a financial burden on students and their families, forcing an increasing number of students to take on unacceptably high levels of debt in order to pursue a college education. The Governor's Fiscal Year 2005 budget restores this money.





Targeted Revenue Enhancements to Protect Education

In Fiscal Year 2005, Governor Holden will, once again, make protecting education his top priority. Although cuts in the budget have already been deep, Governor Holden's Fiscal Year 2005 budget contains additional reductions, but not to education. Despite these spending reductions there is still not enough revenue to cover mandatory increases in health care and prison costs and protect education funding. Therefore, Governor Holden calls upon the General Assembly to choose children and the state's chances for future economic success over corporate tax loopholes.

The Governor believes we must stop giving away limited state resources through special tax loopholes that benefit a few wealthy corporations and place a significant percentage of Missouri businesses at an economic disadvantage. We must also eliminate tax loopholes that do not expand the economy. The loopholes that should be closed will save $121 million and include:

- Geoffrey loophole - $11.3 million – National franchises set up dummy corporations in other states to avoid a large portion of Missouri taxes. Illinois and 25 other states have provisions to close this loophole. Missouri must require corporations to file combined returns to close this loophole.

- Disallow non-Missouri source income - $23.3 million – Missouri may be the only state that allows corporations to avoid paying state taxes on income from out-of-state investments such as bank deposits, stocks, and some loans. This loophole encourages out-of-state investments and applies only to corporations and not individual taxpayers.

- Refunds to purchasers - $7.5 million - Currently, a business that applies for and receives a sales tax refund for taxes they have inappropriately collected from customers is not required to even attempt to find and return the overpayment to the purchaser. A cottage industry of consultants has developed to mine businesses for such sales tax refunds. As a result, sales tax refunds have increased from $15.4 million in Fiscal Year 1996 to a projected $66.0 million in Fiscal Year 2005.

- Disallow single factor - $57.9 million – Most corporations earn their income through business activities in a number of different states. However, Missouri's tax code provides corporations an enormous advantage not given by other states by allowing them the opportunity to choose the method of determining what portion of the corporation's income Missouri taxes. Single factor apportionment is extremely generous to taxpayers who make most of their sales to out-of-state customers, but rely heavily on Missouri infrastructure because they have facilities and employees here. Giving money away through this loophole only benefits about four percent of corporations that file income taxes in Missouri.

- Common carriers - $7.4 million – Years ago the legislature enacted sales tax exemptions for the purchase of trucks, parts, and repairs for "common carriers." When these exemptions were passed, every common carrier was required to register with the federal Interstate Commerce Commission allowing only true common carriers (i.e., trucking companies for hire by the general public) to qualify. Today, anyone can register as a common carrier by paying a relatively modest fee and such registration is no longer required in most cases. As a result, we have seen a substantial number of companies form trucking subsidiaries that carry essentially only the goods of the parent, but call the subsidiary a common carrier in order to claim these exemptions.

- Eliminate timely filing discount for withholding tax - $13.8 million - Missouri businesses receive a discount for sending the income withholding taxes they collect from employees to the state. In other words, businesses keep a substantial amount of these taxes that employees believe they are paying to government for the services they receive. The state of Missouri is the only state that provides this discount, which has been in effect since 1973 and was originally justified on the basis that businesses required a large amount of staff time to figure out how much withholding should be remitted to the state. However, in the Internet age, computers calculate the amounts and the money can be transmitted to the state in seconds. The discount no longer recognizes the cost of this task and should be eliminated.

In addition to eliminating loopholes, Governor Holden recommends increasing targeted revenue sources to protect education:

- <u>Gaming - $115.7 million</u> – The Governor's plan to ensure that the Foundation Formula is protected from crippling budget cuts includes new revenue initiatives from riverboat gaming. These initiatives include:

  - <u>Increase tax on riverboat gaming receipts</u> – $24.5 million. The current adjusted gross receipts tax is 20 percent and is shared by the state (18 percent) and the local governments where the riverboats are docked (2 percent). The Governor's proposal raises the state share to 20 percent and leaves the local share at 2 percent.

  - <u>Increase the riverboat gaming admission fee</u> - $51.1 million. The current $2 admission fee is charged for each two-hour cruise. The Governor proposes changing this to a flat daily fee of $7.

  - <u>Eliminate loss limits on riverboat gaming</u> - $40.1 million. Missouri is the only state in the nation with a loss limit on riverboat gaming. The limit prevents Missourians and visitors from participating in gaming to the fullest extent, puts the state's casinos at a competitive disadvantage, and does not provide an effective deterrent for problem gamblers.

- <u>Cigarette tax - $222.4 million</u> – Tobacco use in Missouri is one of the highest in the nation; 27 percent of adults smoke and about one-third of Missouri teenagers smoke. As a result, Missouri ranks well above average in smoking-related diseases such as heart disease, cancer, and emphysema. The Governor proposes increasing the tax on a pack of cigarettes from the current 17 cents to 72 cents, generating $207.5 million. Currently, Missouri's cigarette tax is fifth from the bottom of all states. The increased tax would move Missouri to about the average rate across the nation, but still below both Illinois and Kansas. In addition, the Governor proposes to increase the tax on other tobacco products from the current 10 percent of wholesale price to 30 percent, generating $14.9 million. These amounts are net of the dollars needed to make up for the loss to the existing cigarette tax that is dedicated to schools and healthcare. When the cigarette tax is increased, cigarette sales will decline, and revenue from the existing cigarette tax will be reduced. This proposal holds the schools and healthcare harmless from this reduction.

- <u>Surcharge on taxable income greater than $200,000 - $11.9 million</u> – The proposal will place a surcharge on the tax paid by those with taxable income greater than $200,000. The surcharge would be five percent of the taxes owed. Currently, an individual with taxable Missouri income of $200,000 owes the state about $12,000 in taxes. The proposal will implement a surcharge of $600 for this individual, only a one-half percent increase. The surcharge will affect only about 1.4 percent of taxpayers.

In addition to these targeted revenue enhancements, the Governor recommends legislation that will require the General Assembly to approve any changes in the federal tax statutes before they can affect Missouri tax revenues. This will help protect education from unexpected revenue loss caused by federal tax code changes. This proposal will also disallow businesses from taking the accelerated depreciation bonus as follows:

- Accelerated depreciation - $48.8 million – The proposal makes the moratorium included in SB 1248 (2002) passed by the General Assembly permanent. Federal accelerated depreciation will no longer be allowed to reduce Missouri taxes. Accelerated depreciation would still be allowed on federal returns.

II. MISSOURI'S REVENUE SITUATION

Overview – Problems with Missouri's Revenue System

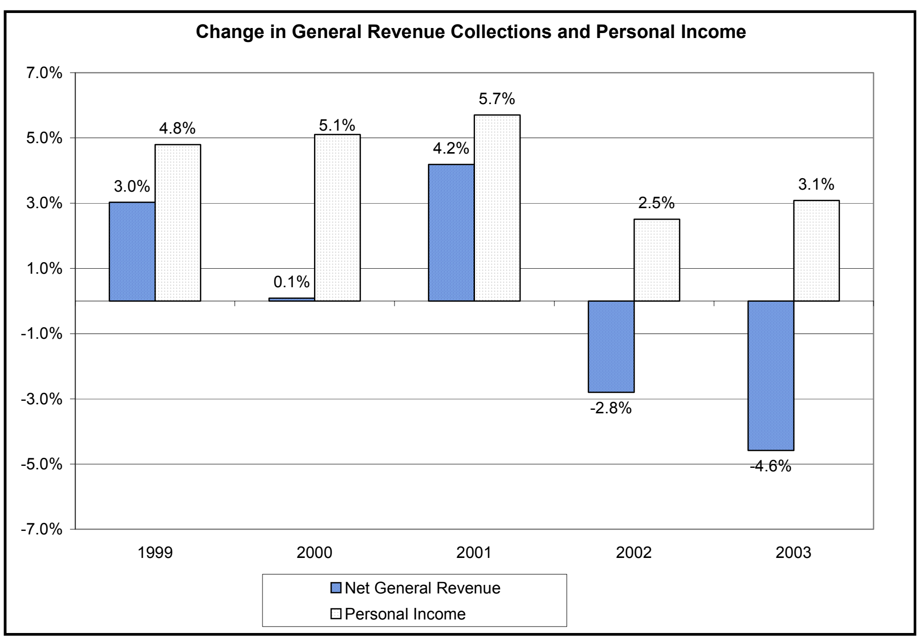
Missouri's tax system has experienced many problems in recent years. These problems need to be permanently addressed or schools, seniors, children, and others who depend upon state services will continue to see services eroded. The problems with Missouri's revenue system include a shortfall in revenue collections, holes in the tax structure, significant control over revenue by politicians in Washington, and a continued reliance on one-time revenue rather than permanent solutions. More specifically:

Missouri has experienced a shortfall in revenue collections.

- In Fiscal Year 2002, Missouri experienced the first decline in net general revenue collections since 1955, ending with 2.8 percent ($178.9 million) less in net general revenue collections than the year before.

- Fiscal Year 2003 brought the second year in a row of declining revenue, with a decrease of 4.6 percent ($284.6 million) in net general revenue collections.

- Declining revenue has occurred despite growth in personal income. Missouri is very dependent on the individual income tax as it makes up about 60 percent of net revenue. Therefore, collections should be closely tied to personal income. However, as can be seen in the following chart, this connection has been missing in recent years:



- Individual income taxes, net of refunds, fell by $382 million between Fiscal Years 2001 and 2003, a ten percent reduction.

- Net corporate and franchise taxes fell by about $100 million from Fiscal Year 2000 to Fiscal Year 2003, a 30 percent reduction.

Missouri's tax structure is full of holes.

- *Governing* Magazine gave Missouri its highest ranking (four stars) for its fiscal management. Missouri was one of only six states to receive four stars.

- At the same time, *Governing* gave Missouri only two stars (out of four possible) for the fairness of its tax system to taxpayers and the adequacy of its revenue.

- *Governing* said Missouri's "tax base is narrow and full of holes created by exemptions for both income and sales taxes. Fairness problems are inevitable when credits and exemptions expand without much review." Further, *Governing* said, "Given a system like that, it's no surprise that private-sector groups bring tax cases to court on a regular basis. There's relatively little to lose and a lot to gain."

- From 1997 to 1999, the General Assembly permanently reduced Missouri's tax base by about $700 million. The biggest reductions were the sales tax exemption for food, increase in the personal exemption for the individual income tax, and exemption of private pensions from income tax. These tax changes have left a permanent and sizable hole in our revenue base.

- In addition to tax cuts, the General Assembly also expanded tax credits. Tax credits grew from $91 million to $163 million (a 79 percent increase) from Fiscal Year 1999 to Fiscal Year 2003. There are also significant amounts of tax credits that have been issued, but not yet redeemed. These tax credits could be redeemed at any time, causing budget uncertainties and placing further strain on revenue collections.

- Dr. Donald Phares completed a study titled <u>Examining Missouri's Tax System: Tax Expenditures – A First Step</u>. In this study, Dr. Phares refers to the loopholes in our tax system as tax expenditures. He notes "… tax expenditures are seldom, if ever, subject to legislative or executive scrutiny… While the normal budget process subjects spending to rigorous and very detailed scrutiny and review, such is not the case with scores of tax expenditures that cost Missouri hundreds of millions of dollars in lost revenue." Dr. Phares goes on to say, "The tax base for the state's two major revenue generators, general sales and individual income, has been eroded through these provisions. In addition and perhaps even more damning for the general sales tax, the definition or scope of its base has been narrowed to tangible items that are a shrinking proportion of consumer spending."

Missouri's tax system is controlled by Washington.

- Missouri's income tax is coupled to the federal tax system. Although there is a good reason for this (ease of tax preparation), it means that the revenue available for vital state sources can be negatively affected by changes to the federal tax code. Federal tax cuts enacted in 2001, 2002, and 2003 will reduce state revenues by an estimated $220 million in Fiscal Year 2005.

- Although it would be too burdensome for taxpayers to completely decouple Missouri's tax code from the federal system, a few minor changes would give the state much more control over its own resources without burdening taxpayers.

SUMMARY OF FEDERAL TAX CUTS ON MISSOURI REVENUES

	FY02	FY03	FY04	FY05	FY06
Cuts Passed in State FY 2001					
repeal of the estate tax	$0.0	($30.0)	($72.0)	($117.0)	($165.0)
all other	($21.1)	($11.6)	($8.6)	($29.3)	($26.8)
	($21.1)	**($41.6)**	**($80.6)**	**($146.3)**	**($191.8)**
Cuts Passed in State FY 2002 and FY 2003	($58.0)	$0.0	($75.3)	($75.3)	N/A
Total	**($79.1)**	**($41.6)**	**($155.9)**	**($221.6)**	**($191.8)**

Missouri has Relied Heavily on One-Time Revenue Sources.

- Missouri has used one-time funding sources to fund ongoing expenses. In previous years, much of the shortfall caused by the disappearance of one-time funds was made up by a combination of growing collections, other one-time sources, and targeted cuts to the budget. However, in the current and upcoming fiscal year, the magnitude of the one-time problem has grown to the extent that significant cuts will be necessary if new revenue is not approved.

- In Fiscal Year 2003, about $435 million in one-time funding was used to support the ongoing budget. These included balances from several funds and one-time revenue from intergovernmental transfer payments and tobacco settlement payments.

- The Governor proposed making up for the loss of these one-time funds in Fiscal Year 2004 through a combination of budget cuts and targeted revenue increases. The General Assembly, however, was opposed to any significant revenue increase. In May, the federal government offered a one-time budget fix for states through increased federal payments. The final budget in Missouri contained a combination of cuts, the one-time federal fiscal relief, and other one-time fixes.

- The most significant components of the current one-time problem are:
  - Federal fiscal relief – The Fiscal Year 2004 budget includes about $387 million in one-time payments from the federal government.
  - Revenue bonds – During Fiscal Year 2003 and Fiscal Year 2004 the state used $150 million and $124.5 million respectively to help balance the budget.
  - Legislation – The General Assembly approved legislation that will generate an estimated $83 million in Fiscal Year 2004. Unfortunately, about $67.2 million of that amount is from one-time sources, such as sweeping balances out of other funds.

Review of the Fiscal Year 2003 and 2004 Budgets

The State of Missouri finished Fiscal Year 2003 with a balanced operating budget, but in a very difficult financial condition. Net general revenue declined 4.6 percent, requiring total withholdings of about $342.6 million. The shortfall was largely due to the continued struggling national economy caused by the uncertainty in Iraq.

While the national and state economy has grown modestly since the beginning of the fiscal year, state revenue collection growth has continued to be slow. Through the first six months of Fiscal Year 2004, gross general revenue collections have been up only 2.4 percent. This is well below the 5.4 percent growth needed to fund the appropriations approved by the General Assembly. Gross collections would have to increase 7.9 percent for the remainder of the year to meet the amount appropriated. While collections net of refunds are up 4.8 percent at the end of December, refunds are expected to increase during the second half of the fiscal year due to the impact of the federal tax cuts and increasing tax credit redemption.

Because the budget approved by the General Assembly did not take these negatives into account, their budget was not balanced and Governor Holden was forced to implement withholdings of $240 million in July. In December, the Governor was notified that the federal government had provided an unexpected $83 million for social services. The Department of Social Services developed a plan to bring reimbursements for Medicaid into the State Treasury a year early. This plan was approved by the federal Medicaid agency. This freed up money that could then be released to schools. The Governor continues to monitor the revenue situation and will release additional money to schools if and when it is fiscally responsible to do so.

The Economic Outlook

U.S. Economy and Outlook – After ten consecutive years of real growth as measured by real Gross Domestic Product (GDP), the U.S. economy fell into a recession in 2001. Fortunately, real GDP growth resumed in 2002 and 2003. For calendar year 2003, real GDP is expected to increase 3.1 percent. The inflation rate as measured by the Consumer Price Index is expected to rise 2.3 percent in 2003. This remains low by historical standards. With the economy still recovering, the national unemployment rate is expected to be 6.0 percent for all of 2003.

Looking ahead, the U.S. economic outlook is guardedly positive. Many leading forecasters, including Macroeconomic Advisers in St. Louis, expect the U.S. economy to improve over the next 18 months. For Fiscal Years 2004 and 2005, the Macroeconomic Advisers forecast is for real GDP to grow 4.6 percent and 4.4 percent, respectively. The inflation rate is expected to be 1.8 and 1.3 percent in the two fiscal years. The U.S. unemployment rate is expected to decline from 6.0 percent to 5.4 percent over the forecast period. This combination of inflation and unemployment will produce a so-called misery index (inflation rate plus unemployment rate) of about 6.7 percent. It is notable that the misery index remains low by historical standards. From 1981 through 1992 the misery index averaged 11.7 percent.

The outlook for improved performance is based on the following factors:

- The Federal Reserve has continued to pursue an expansionary monetary policy, lowering interest rates as recently as June 2003. The federal funds rate target was reduced from 1.25 percent to 1.00 percent.
- Oil prices are expected to remain relatively low. The price of imported oil is expected to be around $23.50 per barrel over the forecast period. This assumes no escalation of hostilities in the Middle East.
- Consumer spending growth has held up well despite the stagnant economy of most of the last two years. This is expected to continue over the forecast period.

In summary, while the U.S. economy appears poised for better times, there is considerable downside risk. For the expected economic improvement to occur many things must happen. These include:

- A sustained stock market recovery.
- Continued strength in consumer spending.
- Business confidence and business hiring must accelerate. This must also lead to enhanced capital spending.

Last and certainly not least, should additional terrorist attacks occur in the U.S. or against U.S. interests abroad, employment gains would likely slow and oil prices would likely rise sharply. This would almost certainly slow the economic recovery now under way. This, in turn, would severely impact state revenues.

Missouri Economy and Outlook – As is the case with the national economy, the Missouri economy has begun to show signs of recovery. The Missouri unemployment rate in November 2002 stood at 5.6 percent. One year later, the Missouri unemployment rate was at 5.0 percent. Jobs have begun to recover with a growth of 30,000 from January 2003 to November 2003. During the same time period, the national economy lost 220,000 jobs. The slowly improving economy has also boosted the rate of growth in Missouri personal income. After growing by 2.5 percent and 3.1 percent in Fiscal Years 2002 and 2003, respectively, growth of 3.3 percent is expected in Fiscal Year 2004. Further, the Missouri Purchasing Managers Index stood at 60.2 in November of 2003. This index purports to predict the direction of the state economy. An index number above 50 generally indicates improving economic conditions.

A modest rebound is expected. The state economy remains diverse with a strong presence in health care services, agriculture, and the travel and leisure industry. Employment in health care services has grown from 195,300 in 1990 to 257,000 in November of 2003. Missouri maintains a very favorable business tax climate evidenced by Missouri's corporate income tax ranking of 46th of 46 states that levy such a tax. As the U.S. economy rebounds, growth in the Missouri economy will likely resume.

ECONOMIC PROJECTIONS

	Increase	
U.S.	**FY 2004**	**FY 2005**
Real GDP	**4.6%**	**4.4%**
Consumer Prices	**1.8%**	**1.3%**
Consumption Expenditures	**5.4%**	**4.8%**
Unemployment Rate	**6.0%**	**5.4%**
MISSOURI		
Total Employment	**0.2%**	**1.1%**
Increase in Personal Income	**3.3%**	**3.2%**

Revenue Projections for Fiscal Years 2004 and 2005

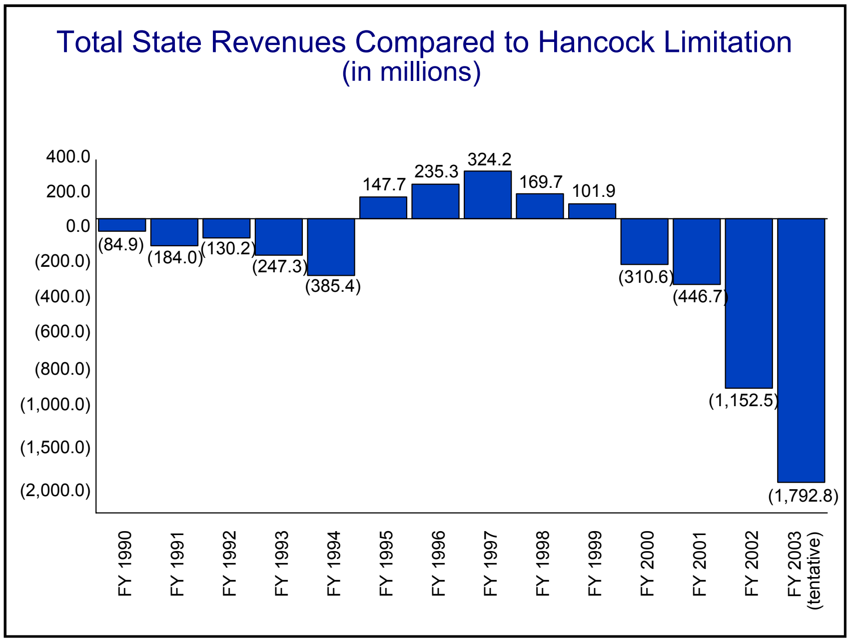
Forecasting revenues is an inherently difficult task, particularly during periods of economic transition and with much uncertainty at home and abroad. The loopholes in Missouri's tax system and its connection to the federal tax code make forecasting even more difficult. Missouri continues to see a growing disconnect between the economy and tax collections.

The revised Fiscal Year 2004 revenue estimate projects that economically driven growth in net general revenue collections will be 2.1 percent. However, after non-economic factors such as the federal tax cuts and growth in tax credits are included, net collections will decline by 0.7 percent from the Fiscal Year 2003 level.

For Fiscal Year 2005, Governor Holden, the Senate, and the House of Representatives have agreed to a consensus revenue foreceast of $6,392.0 million net general revenue collections. This is an optimistic estimate, but is achievable if the economy and employment continue to improve. Also, it assumes the federal government does not make additional tax code changes that would depress Missouri collections. A critical part of the agreement is to reevaluate the situation in April, after additional information is known about revenue collections, and modify the estimate if warranted. All parties agreed to this reevaluation.

Revenue Limitation Amendment

Article X of the Missouri Constitution establishes a revenue and spending limit on state government. The limit is about 5.6 percent of Missouri personal income based on the relationship between personal income and total state revenues when the limit was established and approved by voters in November 1980. Calculations made pursuant to Article X of the Missouri



Constitution show that total state revenues for Fiscal Year 2003 were below the total state revenue limit by $1.79 billion – the greatest amount below the limit since it was established. As measured by the state's revenue limit, in Fiscal Year 2003 Missourians paid a smaller percentage of their personal income to state government than at any time since enactment of the limit in 1980.

The Office of Administration projects that total state revenues will not exceed the total state revenue limit in Fiscal Years 2004 or 2005. These preliminary calculations are subject to change as actual state revenue collections become known and as the federal government revises its estimates of Missouri personal income.

These projections could change if the General Assembly were to pass legislation to increase revenue without a vote of the people under the $75 million limit allowed by the Constitution. Per Article X of the Missouri Constitution, revenue approved by the voters is not subject to the revenue and spending limit.

III. CORE BUDGET REVIEW

Previous Cuts Have Been Deep

The General Assembly has already made deep cuts to the Missouri budget. In addition to the devastating cuts to education discussed previously, examples of cuts already made include:

- $75 million state and federal funds cut from Medicaid resulted in approximately 34,300 Missourians losing health care. This reduction eliminated health care coverage for parents trying to transition from welfare to work and reduced coverage for pregnant women. With the loss of access to preventative care, it is likely that many have ended up in emergency rooms and hospitals with more expensive health care needs.

- $10.3 million cut from the Grandparents as Foster Parents Program. Eligible participants have had their reimbursement rate reduced from $202 to just $68 per month for the 2,500 children served by the program. This has created a financial burden for grandparents who have accepted the responsibility of raising their grandchildren on a fixed income.

- $10.3 million in reductions to psychiatric community programs for over 4,000 seriously mentally ill and emotionally disordered children and adults. Services reduced include outpatient treatment, residential treatment, case management, recovery supports, and crisis intervention alternatives.

- $7.2 million in reductions to community programs for 2,000 disabled Missourians, resulting in reduced services to autistic clients, day habilitation, respite care, and transportation services.

- $3.8 million in reductions to substance abuse treatment services, resulting in more than 1,300 clients no longer having access to services. These include services such as Oxford Houses and Comprehensive Substance Treatment and Rehabilitation (CSTAR) programs that serve pregnant women and women with children.

- $3.1 million cut from environmental health and communicable disease prevention efforts. These reductions occurred while new and increased demands continue to develop such as West Nile disease and Severe Acute Respiratory Syndrome (SARS), anthrax investigations, and soil, water, and air contamination.

- $3.6 million for women's primary health care services was eliminated. This program served over 30,000 low-income women throughout the state. Consequences of not funding this program include undiagnosed venereal diseases and cancer, inadequate prenatal care, low birth weight babies with complex short-term and long-term health problems, and higher infant mortality. For Fiscal Year 2005, the Governor recommends $5 million to provide a comprehensive health services program that includes reproductive health services.

- $2.6 million was cut from the Department of Corrections, resulting in the elimination of 88 institutional staff positions including cooks, caseworkers, teachers and maintenance staff. These reductions put greater strains on the correctional officers who supervise the inmates as more of their efforts must be directed to covering the duties of the eliminated positions.

- $6.2 million was cut from the Customized Job Training program. This has resulted in fewer companies receiving assistance, and smaller awards for those that do. Employees receiving training decreased from 35,613 to 24,639, which translates into a less competitive workforce and fewer high-paying jobs.

- $1.1 million in technology funding cuts has resulted in the elimination of the Centers for Advanced Technology and Electronic Materials Applied Research Center programs. The Manufacturing Extension Partnership Program and Innovation Centers have also received less funding. These combined actions have resulted in fewer research projects and fewer companies that are served with technology and commercialization activities. This will have a negative impact on the amount of new investment and sales generated by companies that use these programs.

- $180,688 was cut and forced the closure of the Cameron Veterinary Laboratory. This facility handled the laboratory component of the State Meat and Poultry Inspection Program and provided diagnostic testing for animal diseases in Northwest Missouri.

- $4.6 million in assistance for transit providers has been reduced, eliminating approximately 1.3 million trips. Many people rely on public transportation to get to work, to get to medical appointments and to carry out other daily activities.

- $4 million for Landmark Local Park grants has been eliminated. This grant program provided an essential source of revenue for developing park and recreation facilities throughout the state.

- State employees have been cut significantly, particularly general revenue funded staff. For example, from Fiscal Year 2001 through 2004:

  - The Department of Economic Development lost 48 percent of its general revenue staff.
  - The Office of Administration lost 25 percent.
  - The Department of Public Safety lost 18 percent.
  - The Department of Health and Senior Services lost 16 percent.
  - The Department of Mental Health lost 14 percent.

These cuts have led to reduced services for Missourians and increasing workloads for remaining employees.

Streamlining Government

Between Fiscal Years 2001 and 2004, over 2,000 positions have been permanently cut from the Missouri budget. The Governor's budget recommendations for Fiscal Year 2005 include a net reduction of an additional 1,000 positions, bringing the total reduction to about 3,000 positions.

Comparing 2003 to 2002 year-to-date employment information, Missouri had the sixth largest percentage **decrease** in state and local government employees of all the states. Oregon, Michigan, Connecticut, Massachusetts, and West Virginia had bigger percentage reductions. All other states had smaller reductions or actually had growth in government employment.

When comparing Missouri to 12 other comparable states (13 including Missouri), Missouri ranks third from the bottom in the number of administrative employees per 10,000 people.

Although Missouri has already made deep administrative cuts and improved the efficiency of operations, Governor Holden continues to encourage all agencies to look for additional ways to save taxpayer dollars. Under the Governor's leadership, the following additional efficiencies will be implemented:

Early Retirement – The incentive plan, authorized by SB 248 (2003), will result in the elimination of 557 positions and save $10.5 million general revenue, $18.2 million total.

Spend Management – The Office of Administration has negotiated a contract with a firm that specializes in reducing procurement spending. The contract guarantees savings of at least twice the cost of the services provided, and the contractor projects annual savings of between $6 and $9 million, all funds, in the first year. Additional savings are expected in future years. The effort is two-pronged – make sure the state is getting the best price possible and buy only what is actually needed. This effort will allow departments to more effectively operate despite large cuts in their Fiscal Year 2004 budgets.

Responsible Debt Management – The state of Missouri is one of only seven states in the nation that have received the highest, "Triple A", bond rating from Moody's Investors Service, Standard and Poor's Corporation, and Fitch Ratings. Maintaining a high rating is important because it saves taxpayers money. The Office of Administration also keeps borrowing costs as low as possible by refinancing debt when market conditions warrant, saving over $69 million over the last two fiscal years. To continue achieving savings, the Governor recommends $200,000 in Fiscal Year 2005 to implement a debt management program. These funds will allow the use of outside consultants to monitor the state's debt and act quickly to save money on ongoing debt payments.

Telecommunications Savings – Representatives from private business joined with several state agencies to lower telecommunications costs. Team recommendations include developing audit guidelines to help agencies assess their current services, factor actual telecommunications costs into evaluation criteria for state leased facilities, and amend purchasing contracts to allow for extended terms and more negotiations. The estimated cost savings over the next several years could be more than $3 million, all funds.

Vehicle Fleet Management – Following the directive of Governor Holden, the state has reduced its passenger vehicle fleet by 960 vehicles since 2002. These efforts have reduced the fleet size by nearly 20 percent. A new initiative calls for an initial reduction of 25 percent of vehicles traveling less than 5,000 miles per year. The vast majority of these vehicles are special function vehicles such as mail delivery and facility support vehicles. Research is also underway to determine options to reduce maintenance and repair expenditures for state vehicles.

Information Technology Consolidation – Efforts continue to effectively manage the state's information technology (IT). An interagency review committee has recommended the state move to a single e-mail system and the Governor has directed the implementation of this recommendation. Savings will be generated by using the state's purchasing power to get the best deal on hardware and software and by only training employees to use one system. Staff now working on maintaining these multiple systems can be redirected to other critical needs. Savings will be redirected towards reengineering and consolidating business processes to eliminate duplicate systems, and improving the state's IT infrastructure to take advantage of other cost-saving mergers. Other IT operations being evaluated for future consolidation include servers, network management, and PC administration and support.

Medicaid Cost Containment

Missouri has undertaken numerous initiatives to control the costs of its Medicaid Program. Cost control measures have saved over $300 million state and federal funds in the Pharmacy Program alone. Because of rising health care costs and the crisis Missouri is currently experiencing with stagnant revenues, the Governor's budget includes numerous cost containment measures to curtail escalating Medicaid expenditures. Combined, these efforts will save about $51.9 million general revenue in Fiscal Year 2005. Savings will increase in future years. Cost containment efforts include: carrying out the final steps of a preferred drug list; expanding disease management and case management efforts; implementing copayments on some services; reducing rates paid to providers so they do not exceed normal Medicaid rates; improving the efficiency of the non-emergency medical transportation program; and implementing several efforts to ensure Medicaid does not pay for costs that should be paid by private insurers.

Tax Credit Accountability

Once again Governor Holden is calling on the General Assembly to pass a tax credit accountability and reform bill. Many of these programs have produced outstanding results for businesses, communities, and the state. Others, however, should be eliminated, modernized, or reformed because they have not fulfilled their promise or have provided an inadequate return on the state's investment. Currently there are 53 tax credit programs authorized by law. Twenty-five of those programs have been passed into law by the General Assembly since 1990. These credits alone have cost the state over four billion dollars during this 13-year period.

More Efficient Prisons

The oldest prison west of the Mississippi, the Missouri State Penitentiary, will be closed in Fiscal Year 2005. The sprawling facility had become too costly to operate and will be replaced with a new Jefferson City Correctional Center. With continued budget pressures, it is also necessary to close another inefficient prison. The Chillicothe Correctional Center will be closed and its 525 women offenders will be moved to space in the Tipton Correctional Center. The Chillicothe facility was opened in 1895 as a juvenile detention facility. An assortment of buildings were added through the early 1900s and in 1981 the facility was converted to a correctional center for women offenders. Now, there are looming repair and renovation costs of $9.7 million. In addition, savings from operating costs in Fiscal Year 2005 will total $1.7 million, with additional savings in Fiscal Year 2006 of $1.2 million. Some additional costs will be incurred because of the move, and living within Missouri's existing prison space may be a challenge. Regardless, the move will result in a net savings to the state.

Managing for Results Initiative

Governor Holden's Managing for Results Initiative (MRI) is a long-term commitment to doing business more efficiently and effectively. MRI is a management tool for the Governor and his cabinet to help keep government focused on results and to drive meaningful improvements for citizens. MRI encourages fact-based decision making and innovation and recognizes the need for agencies to work together to drive significant improvements. Agency projects have saved millions of dollars and countless hours for Missouri citizens and state employees. These projects have helped agencies cope with significant cuts in their salary and expense budgets. Descriptions of these projects can be found at the MRI website (www.mri.missouri.gov). MRI projects include:

- Department of Social Services Child Support Enforcement Team – Child support collections were not reaching the children and their families who depend upon them on a timely basis. The team recommended improvements to the computer system and enhanced efforts to locate current addresses. These efforts have led to a 50 percent reduction in undistributed collections.

- Department of Corrections (DOC) Victim Services Team – Victims were not always being notified in a timely fashion about upcoming parole hearings. The team recommended focusing on high priority cases, improving coordination between DOC and local law enforcement agencies, and increasing use of the Internet to speed up notification. These efforts have led to a 100 percent success rate in providing 30-day advance notification of parole hearings.

- DOC Population Growth Team – Offender population has been expanding rapidly. Left unchecked, new prisons will have to be built at a significant cost to the taxpayers. The team recommended better training for probation and parole staff, enhanced case management of parolees, and increased use of performance data to identify areas of the state with high return-to-prison rates. These initiatives coupled with efforts of the Board of Probation and Parole have reduced incarcerated offender population growth from 4.56 offenders per day in Fiscal Year 2002 to 1.39 offenders per day in Fiscal Year 2003. The ongoing initiatives of this team and the Board of Probation and Parole, coupled with the implementation of sentencing reform included in Senate Bill 5 (2003), will continue to reduce the growth of the incarcerated offender population.

- DOC Recycling Team – DOC has saved over $100,000 through the recycling of trash in several of its correctional facilities. Efforts are underway to expand recycling efforts to 17 other institutions. The annual savings of these institutions, combined with expanded recycling efforts within other DOC facilities and other participating state agencies, is expected to reach over $1 million. An interdepartmental team, sponsored by DOC, is developing a plan to aide in the expansion of recycling efforts to other departments.

- Department of Labor and Industrial Relations Appeals Team – Unemployment compensation appeals were taking too long to be resolved. The team recommended establishing a specialized unit to hear most common cases, better training, and other improvements. As a result, the backlog has been reduced from a high of 6,800 cases down to just 200, with total backlog elimination expected in 2004.

- Office of Administration Statewide Mail Team – The cost of mail was increasing at the same time departments' budgets were being cut. The team recommended use of computer technology to verify addresses, sort mail, and apply bar codes. The team also recommended revising the mail services contract to obtain cheaper rates. Through these efforts, $1.5 million in savings have already been realized with eventual savings of $1.9 million anticipated for all funds. These savings will allow agencies to manage operations despite large reductions in their expense budgets.

- Department of Mental Health (DMH) Collections Team – This project increased payment collections in FY 2003 by $534,498 from private insurers and MC+ providers. It is anticipated that full implementation will increase collections for services rendered by over $2 million dollars per year. Improvements included negotiation of statewide service agreements with large third party payers, language in MC+ contracts to ensure payment for services provided to individuals who are civilly committed to DMH hospitals, and staff assigned at each acute care facility to ensure payment for services provided.

IV. FISCAL YEAR 2005 SUMMARY OF RECOMMENDATIONS

Overview

Fiscal Year 2005 base operating appropriations after core cuts are $6,620 million. New operating budget appropriations of $442 million are recommended to continue high priority existing programs, cover increasing Medicaid caseloads and costs, address security needs, respond to the expected growth in prison inmate population, provide for increased state employee health care costs, and implement new legislation. This brings the total general revenue operating budget to $7,062 million.

A total of $40 million has also been set aside for supplemental appropriations and increases in estimated appropriations.

Protecting Education

The Governor's Fiscal Year 2005 budget recommendations include restoring the money cut from education by the General Assembly as follows:

- $100 million for the Foundation Equity Formula and At-Risk Program.
- $9.9 million for the School Transportation Program.
- $2.4 million for Parents As Teachers.
- $1.5 million for the Gifted Program.
- $800,000 for Vocational Education.
- $34.2 million for Missouri's four-year colleges and universities.
- $7 million for Missouri's community colleges.
- $255,588 for Linn State Technical College.

In addition, the Governor recommends:

- $20.7 million for Early Childhood Special Education for educational services provided to three- and four-year-old children with disabilities.
- $2.8 million to provide early intervention services for developmentally delayed infants. This will provide services to an additional 221 children.

Increasing Jobs

In December, Governor Holden announced Jobs Now, a comprehensive plan to accelerate the state's economy as it continues to emerge from the national recession. Jobs Now will create new jobs through targeted investments in critical infrastructure, help stimulate the growth of our targeted industries like the plant and life sciences, and provide increased funding to ensure a highly skilled workforce in the state. The plan is cost neutral because it will re-direct resources from several inefficient tax credit programs and will leverage non-state investments from private sources and federal funds. In addition to the Jobs Now Initiative, the Governor recommends:

- $6.5 million Temporary Assistance for Needy Families (TANF) bonus dollars for training and career development opportunities to help low-income families find and retain jobs.

- $688,477 to provide the necessary resources to implement the Missouri Downtown and Rural Economic Stimulus Act, as authorized by HB 289 (2003).

- $500,000 for the Arts Council to match available federal funds. Funding for the arts attracts tourists and spurs economic activity that improves state and local economies.

Protecting Children

Governor Holden ordered a review of the child welfare system in 2003 in response to the tragic death of a Missouri child. Because of the review's findings, the Governor directed a reorganization of the department and created a division focused on the health and safety of children. Together with the Judiciary, the General Assembly, and child advocates from across the state, the Governor has worked to develop a comprehensive system to protect all children. While there have been many changes in Missouri's Child Welfare Program, some areas still need improvement. In order to strengthen the state's child welfare system and expand the opportunities for youth in state custody, the Governor recommends:

- $9.3 million, including $6.1 million general revenue, to begin the process of gaining national accreditation for the state's child welfare program from the Council on Accreditation. Accreditation will provide additional tools to staff and lower unmanageable caseload sizes. Children facing abuse or neglect deserve to have a trained and dedicated child welfare team to intervene on their behalf.

- $1.1 million, including $521,826 general revenue, to provide fingerprint checks against the Missouri Highway Patrol and FBI databases for all those who provide care for children in state custody.

Assisting Seniors and the Disabled

Missouri Senior Rx Program -- For Missouri seniors, the affordability of prescription drugs continues to be a serious concern. Prescription drug coverage through Medicare will not be available until 2006 and even then it will be limited. For seniors with limited resources, choosing which prescription to fill is, unfortunately, a choice they often must make. During a special session called by Governor Holden in September 2001, the General Assembly approved the Missouri Senior Rx Program to provide drug coverage for seniors with individual incomes below $17,000 or household incomes below $23,000. After the seniors meet an annual deductible, the Missouri Senior Rx Program will pay 60 percent of the cost of prescription medications up to a maximum of $5,000 a year. The program is serving about 19,000 low-income seniors. The average annual income for current participants is only $12,322. The Governor recommends:

- $7.5 million to pay for drug costs of about 5,000 additional seniors in the Program.

- Modifying the program to assist 85,000 to 145,000 Missouri seniors who will be left out of the recently announced federal drug program.

Expanded Health Care Coverage for Seniors and the Disabled – Health care access for the elderly and disabled will be improved by increasing the federal poverty level used to determine Medicaid eligibility from 90 percent to 100 percent. The eligibility expansion will allow individuals with monthly incomes up to $748 to be Medicaid eligible. Approximately 20,000 elderly and disabled people will become eligible to receive full Medicaid coverage. The Governor recommends:

- $21.1 million, including $8.2 million general revenue, to expand Medicaid eligibility for the elderly and disabled from 90 percent of the federal poverty level to 100 percent of the federal poverty level.

Expanding Services for Mental Health Clients – The Governor recommends $16.8 million, including $6.5 million general revenue, to provide services to an additional 2,400 clients of the Department of Mental Health. This will serve about 980 children and adults with severe mental illness, 175 developmentally disabled children and adults, and 1,248 children and adults with alcohol or drug abuse problems.

Ensuring Women's Health

The Governor recommends $5 million for comprehensive health services for low-income individuals with unmet health needs such as screenings, education, treatment for chronic and infectious diseases, and reproductive health services. These funds will provide services to about 26,700 low-income women.

Enhancing the Safety of the Public

Governor Holden continues his commitment to equipping the Department of Public Safety and local law enforcement with the tools needed to protect Missouri citizens from crime. The Governor recommends the following measures to ensure the general safety of the public at large:

- $5.2 million state highways and transportation department fund to upgrade Highway Patrol communication capabilities and pay for criminal justice data processing expenses.
- $1.6 million federal and other funds to support and enhance crime lab and forensic science services.
- $1.2 million federal and other funds to enhance the Highway Patrol's automated fingerprint identification system, pursuant to SB 184 (2003), by developing and integrating a computer-searchable database of palm prints.

Caring for Veterans

Missourians have served with distinction in the armed forces of our nation, placing their lives at risk in order to preserve our freedom. Governor Holden recognizes the special debt owed to these guardians of liberty. The Governor recommends the following measures to support veterans.

- $1.8 million and 93 staff to comply with federally prescribed veterans' home nursing care standards.
- $1.1 million for increased pharmaceutical costs at veterans' homes.
- $818,593 veterans' commission capital improvement trust fund to administer the Korean Conflict Medal Program pursuant to SB 219 (2003).
- $105,282 to coordinate ongoing benefit awareness efforts to minority veterans statewide.

Increasing Funds for the Treatment of Sexually Violent Predators

Persons deemed by the courts to be sexually violent predators are committed to the custody of the Department of Mental Health for control and treatment until they can safely return to the community. The courts have also tended to place individuals in the department's custody pending final determination of their status. The program began in January 1999 at the Southeast Missouri Mental Health Center, and the number of individuals detained or committed has steadily increased. Governor Holden recommends an increase of $1.2 million for an additional 17-bed ward. It is projected that the Center will be at full capacity by July 2004.

Investing in Missouri State Employees

The state of Missouri competes for qualified, high performing employees at all levels of government. This becomes increasingly difficult when salary levels stagnate. Because of the poor economy and associated devastating budget reductions that have occurred across Missouri state government, only one small pay increase has been funded over the last three years. A system-wide cost-of-living adjustment has not been made to employee salaries since Fiscal Year 2001, while Missouri personal income has increased nearly nine percent. Only one of Missouri's eight contiguous states (Oklahoma) has not provided state employees pay increases in the past two years. Through these tough budget times, state employees have remained dedicated to providing critical services for Missouri citizens.

Census data from 2002 show that Missouri ranks 49th in average state employee salaries. In Fiscal Year 2003, more than 80 percent of state employee salaries were below the market rate. Successive years without increases for experienced employees has resulted in a compression of the majority of state workers in the lower pay steps on each range. Consequently, it is becoming increasingly difficult to fill vacancies and keep employees, especially in certain critical job classes. For example, the turnover rate for nursing positions ranges from 20 to over 50 percent. The turnover rate for psychiatric aides in the state's mental health facilities is about 20 percent. Around one-fourth of all youth specialists working with juvenile offenders leave each year, and the turnover rate for corrections officers is 17 percent. Every year, 15 to 20 percent of social service workers leave. High turnover rates cost Missourians due to increased training and overtime for remaining staff, and reduce the overall effectiveness and efficiency of state government.

To maintain a high-performing state workforce, the Governor recommends:

- $46.2 million, including $23.9 million general revenue, for a two percent cost of living increase for all employees, including related fringe benefits. The cost of the pay plan without accompanying fringe benefits is $39.5 million, including $20.1 million general revenue.

- $19.4 million, including $15.6 million general revenue, for increases for certain critical classes, including related fringe benefits. The cost of the increases without accompanying fringe benefits is $16.5 million, including $13.2 million general revenue.

- $44.5 million for continuing health care benefits, including $29 million general revenue.

- $5.6 million to implement SB 248 (2003), which increased the state's contribution for health care for certain early retirees, including $3.7 million general revenue.

- $3.9 million to increase the state subsidy for the employee/spouse and employee/family categories to 83 percent, including $2.5 million general revenue.

- $21.2 million to fund the retirement system, including $13 million general revenue.

Links to Financial Summaries and Tables: